



# **City of Carlsbad 2007-08 Preliminary Operating Budget and Capital Improvement Program**

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# CITY OF CARLSBAD, CALIFORNIA 2007-2008 PRELIMINARY BUDGET

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## Carlsbad City Council

2007

### Five-Year Vision Statements



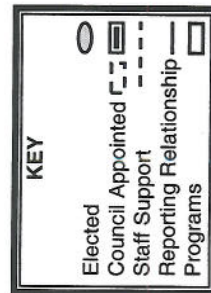
***City Council continues to clarify and pursue the vision of Carlsbad that reflects the pride and quality of life for all who live, work, and play here.***

#### ***Carlsbad . . .***

- Provides a diverse and healthy economic base that creates opportunities for employment to the residents of Carlsbad, economic vitality to the community, and the necessary revenues to support City services.
- Provides programs, policies and decisions to implement the General Plan, enforce the Growth Management Plan, maintain the safety and security of its citizens, and are based on what is best for Carlsbad.
- Occupies a leadership role in local and regional planning, (e.g., water, beach, circulation, and environmental issues) important to local governments and is actively involved addressing governmental issues at the local, state and national levels.
- Provides an open government leading to the betterment of the community and encourages in a non-partisan manner active citizen participation and involvement with the City Council and the City's Boards and Commissions.

#### ***And Carlsbad Efficiently and Effectively...***

- Delivers top-quality public services.
- Manages its environment proactively, including:
  - ◇ Open space
  - ◇ Wildlife habitats
  - ◇ Water quality/conservation
  - ◇ Beach preservation
  - ◇ Air quality
  - ◇ Resource conservation and waste reduction
- Promotes a safe and efficient integrated transportation system.
- Maintains citywide "small town" community spirit.
- Provides a community where continuous and life-long learning is supported and encouraged for people of all ages.
- Looks ahead and works to anticipate changes that are required now in order to make a better future for its citizens.



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# CITY OF CARLSBAD

## 2007-08 PRELIMINARY BUDGET

Carlsbad is a full-service City providing the following:

- Police department
- Fire department, including paramedic
- Water delivery system
- Sewer system
- Solid waste services
- Housing programs
- Development services
- Street construction and maintenance
- Library and Arts programs
- Recreation programming for all ages
- Park lands
- Municipal Golf Course

School programs and facilities are provided by four different school districts located within the City boundaries. Although the City Council has no direct control over these school districts, the Council recognizes the importance of quality school facilities and programs to Carlsbad's residents. The Council has worked closely with the schools in the past, and staff continues to meet with them on a regular basis.

### BUDGET PROCESS

The budget process for the City of Carlsbad begins in January each year, with a review and update of the City Council's five-year vision statements. Through the vision statements, Council defines and clarifies their vision of Carlsbad. The City Council also provides the City with their top 15 priority projects, which further defines their vision. The strategic goals for the City are developed next. These statements are reflected in the box on the right. The goals further define the methods used to achieve the vision and highlight areas where Council desires to place special emphasis during the year. Once the vision,

goals and priority projects are developed, staff develops operational goals based on Council's direction. These operational goals are the basis for the development of the Operating Budget.

### City of Carlsbad Strategic Goals

**Balanced Community Development** - A city that connects community, place and spirit, through balanced and economically sustainable land uses.

**Citizen Connection And Partnership** - A city that embraces Community connectivity through the effective use of technological and interpersonal mediums.

**Communication** - Ensure that community members, Council and staff are well informed, continuing to be a more responsive government while providing a high level of citizen confidence in its government.

**Environmental Management** - An environmentally sensitive community by focusing on: conservation, storm water, sewage collection and treatment, solid waste, and cost effective and efficient use of energy including alternative energy sources.

**Financial Health** - Pursue and implement proactive strategies that support sustainable economic health and manage fiscal resources effectively.

**Learning, Culture & Arts** - Promote and support continuous learning, cultural opportunities and the arts within the community and the City organization.

**Parks / Open Space / Trails** - Acquire, develop and maintain a broad range of open space and recreational facilities that actively address citizen needs which are fiscally responsible, and are consistent with the General Plan and Growth Management Standards.

**Top Quality Services** - A city that provides exceptional services on a daily basis.

**Transportation / Circulation** - Provide and support a safe and efficient transportation system that moves people, services and goods throughout Carlsbad.

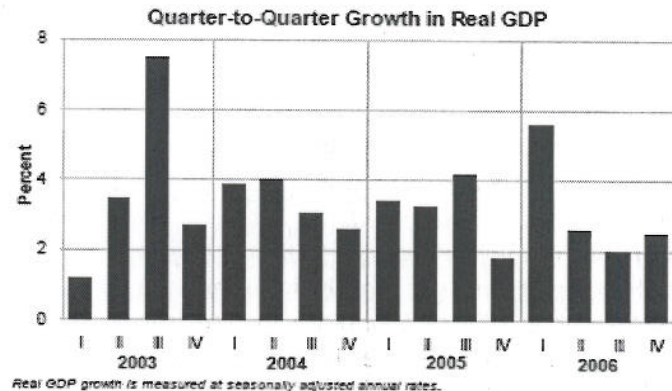
**Water** - Ensure, in the most cost-effective manner, water quality and reliability to the maximum extent practical, to deliver high quality potable and reclaimed water incorporating drought-resistant community principles.



Carlsbad's Operating Budget is a tool that guides the achievement of Council's vision, goals and priority projects for the City. The budget allocates the resources, and sets the priorities for all of the programs offered by the City. Thus, it is an integral part of making Carlsbad a wonderful community in which to live, work, and play. In addition, the budget is a fiscally conservative balanced budget, to effectively sustain the community and essential City services far into the future.

## ECONOMIC PROFILE

The **US economy** has experienced steady growth over the past several years, however the economy is now in a slow down period which is expected to last the first three quarters of 2007 and then begin to return to normal the fourth quarter of 2007. According to the Bureau of Economic Analysis the economy grew at an annual rate of 2.5% in the fourth quarter of 2006. This growth rate was revised upward by .3% from the "preliminary" estimates. The adjustment was due to a higher than expected increase in consumer



spending, exports, Federal government spending, and a reduction in imports, slightly offset by investment in inventories, equipment and software. According to preliminary estimates released by Global Insight and the UCLA Anderson Forecast, real gross domestic product – a measure of economic activity – is expected to increase 2.1%, 1.7% and 2.5% in first, second and third quarters of 2007 respectively. For the fourth quarter of 2007, real GDP is expected to increase closer to 3% and it is forecasted that GDP for 2008 will average 3.25%. While the US economy is slowing, a recession is not anticipated by UCLA Anderson Forecast and other economic think tanks due to the strength in the job market. Most recessions are linked with significant cycles of job loss, which currently is not the case. In addition, because most Americans are employed, it is expected that the majority will be able to continue to pay their mortgages, segregating the sub-prime mortgage concern to a small percentage of the population.

While UCLA Anderson Forecast is not expecting a recession, there are some unknowns that may result in a higher risk potential. The housing market is expected to be slow but is it still unclear how slow it will be. With flattening housing prices, and in some areas, actual declines in housing prices, there may be more risk to the economic outlook as more defaults on mortgages occur. UCLA's economists also predict that there will be pressure on the Federal Reserve Board for more interest rate reductions during 2007 to compensate for inflation and the slow down in the economy.

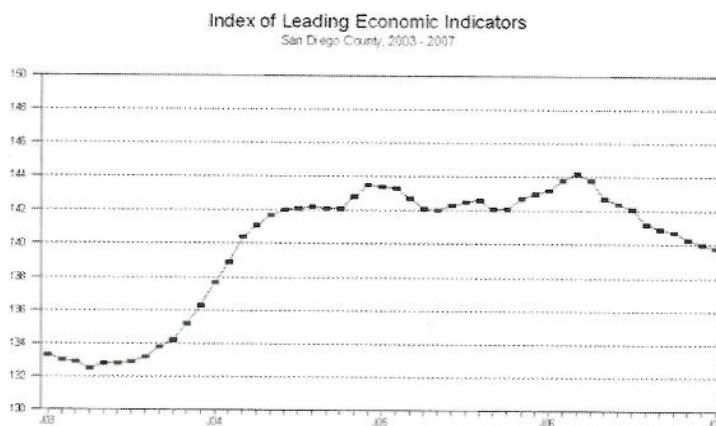
**California's economy** has also slowed. California experienced four years of high home price appreciation which resulted in home affordability at an all time low throughout many areas of California, according to UCLA Anderson Forecast. Several entities were determined to continue to keep sales volumes high and relaxed credit standards in order to continue to sell homes. This resulted in the subprime mortgage market which is now part of the threat to the real estate market. Mortgage defaults are rising with the potential of high foreclosure rates during the summer of 2007. The government and lenders are working on bail-out procedures to reduce the number of foreclosures by working with the troubled borrowers to refinance their mortgages.



According to the UCLA Forecast, at the end of 2006, the high-end service sector jobs were able to compensate for the job losses in construction and financial services related to real estate. For 2007, UCLA Anderson Forecast is expecting the real estate sectors to continue to slow down the economy. Given this forecast, according to the UCLA Anderson Forecast:

"We expect to see job growth in California slow to below 1% through the middle of 2008, with growth in real personal income and real taxable sales slowing to just over 2% through this period. If the Professional/Business Services sector can sustain its momentum longer in 2007, we might see a milder slowdown; but if the carnage in subprime markets is more severe than we expect, job losses in Southern California could make things a bit worse. But the essential logic of the no recession forecast remains: while there's some wiggle room on how weak real estate will be and how much other sectors will offset this weakness, there still is no other sector that looks poised to combine with real estate to generate enough job loss to cause a recession."

Locally, the **San Diego economy** has slowed as well, according to several local economists, including University of San Diego (USD) economist Alan Gin. The job losses in construction and financial industries are partially offset by the leisure and hospitality industries, however, it is not clear if this offset will continue into the future. Employment in construction declined 3,800 in January compared to the same time a year earlier and real estate related jobs declined by 2,200. According to Alan Gin, these job losses as well as higher gasoline prices are likely to continue to negatively impact the local economy. In addition, according to Alan Gin, residential permits have declined for ten months in a row through April 2007. A chart reflecting USD's economic indicators is reflected below.



According to the UCLA Anderson Forecast, there are many new homes in the San Diego County area and builders are anxious to reduce their inventory, thus reducing the price of new homes. UCLA Anderson Forecast is predicting that new homes in San Diego area will see a price decline due to the builders' angst to reduce inventory. For re-sales, it is anticipated that owners are not going to be as anxious to move and will wait for a good price for

their home, thus the price for re-sales is expected to level off but not decline.

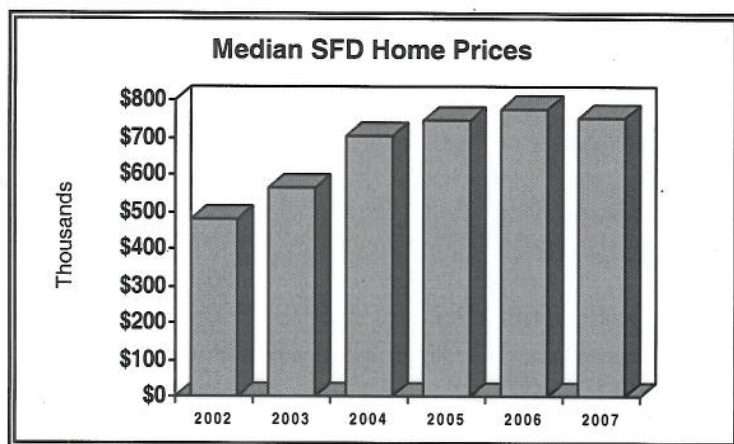
UCLA Anderson Forecast is predicting that building activity will slow through 2007 with a slight rebound in 2008. Job growth is expected to slow as the leisure and hospitality sectors lose momentum in 2007 offsetting less of the job losses in construction and real estate sectors. In addition, the credit crunch is expected to continue to weaken home sales and an anticipated increase in foreclosures may impact home prices.

However, even with the economy slowing, the USD index for consumer confidence has been up for the last five months. It is unclear how and when the real estate market and gasoline prices will impact USD's consumer confidence index.



**Carlsbad's economy** is tied closely to that of the San Diego region, although development patterns may differ. Carlsbad is experiencing strong growth in FY 2006-07 in property and Transient Occupancy Taxes (TOT). Property taxes are expected to grow by over 21% reflecting the continued escalation in housing prices during FY 2006-07, new development, as well as the return of \$1.8 million in property taxes that the State of California took from the City of Carlsbad during fiscal years 2004-05 and 2005-06. TOT, the City's gauge of the tourism industry, are expected to end the fiscal year showing over an 11% gain, with a large part of that coming from the reopening of a major portion of one of Carlsbad's premiere resorts as well as reflecting a full year of the West Inn which opened in May 2006. Sales taxes are slowing during FY 2006-07 due to the slower economy as well as a decline in auto sales, however, even with the slow down, we are anticipating an additional \$700,000 over FY 2006-07.

Carlsbad's residential real estate market has slowed significantly throughout FY 2006-07. The City expects to issue approximately 425 residential permits this year, a decrease from the 943 in the previous year. The number of permits is expected to decline due to a lack of supply and a slowing economy. There are a number of new residential communities under construction or in the final phases of development that will add to the residential housing stock in Carlsbad. The Villages of La Costa projects known as the Oaks North, the Greens and the Ridge are under construction, and will add approximately 970 single-family and 450 multi-family units. The Bressi Ranch area is almost complete with 523 single-family and 100 multi-family units developed. In addition, the Robertson Ranch area, which is expected to contain over 1,000 residential units, is finishing up its master plan. The completion of these master planned communities will signal an end to the large-scale residential developments in Carlsbad.



As the housing market has cooled, the housing prices have slowed as well. The median price for single-family homes in Carlsbad was \$777,000 for April 2006 compared to \$750,000 for April 2007 a decrease of 3.5%. The total assessed values in the City stand at over \$22 billion; an increase of nearly 58% over what they were just five years ago. With the new developments mentioned earlier starting to sell this year, the City has projected it will add about 2,117 more residential units and an

additional 3.7 million square feet of commercial/industrial development over the next five years. The City's residential housing stock is about 90% built out, with approximately 4,658 housing units remaining to develop.

Commercial and industrial development has been averaging 800,000 square feet per year. This is expected to remain about the same over the next five years to average 820,000 square feet per year with the large industrial developments including Carlsbad Raceway, Oaks North Industrial Park and the La Costa Town Center. Some of the major companies in town include the Gemological Institute of America, ViaSat, Invitrogen, Callaway, Taylor Made, Upper Deck, and many others.

Commercial development has brought much needed entertainment and shopping venues to citizens and visitors alike, as well as generating additional sales taxes to help pay for City services. Carlsbad is home to Car Country Carlsbad – an auto mall; the Carlsbad Premium Outlets – a specialty outlet center; Plaza Camino Real – a regional shopping mall; a Costco center; and the Forum at Carlsbad - a commercial center with upscale retail shops, restaurants and other commercial uses.



Development has also enhanced Carlsbad's reputation as a destination resort for tourism. The City is host to a major family theme park: Legoland, and has two luxury resorts available for its visitors: the Four Seasons Resort at Aviara and the La Costa Resort & Spa. There are also a number of other quality hotels and motels in the City, with the most recent addition being the West Inn, which opened in May 2006.

The City of Carlsbad will be opening a municipal golf course in the summer of 2007 which is expected to further enhance the tourism attractions the City offers. The municipal golf course, The Crossings at Carlsbad, is an 18 hole, destination golf course set in the rolling hills and canyons of Carlsbad. With ocean views, high quality golf experience, a first class restaurant and clubhouse, and linkages to hiking trails, The Crossings at Carlsbad will be a destination spot for golfers and non-golfers alike.

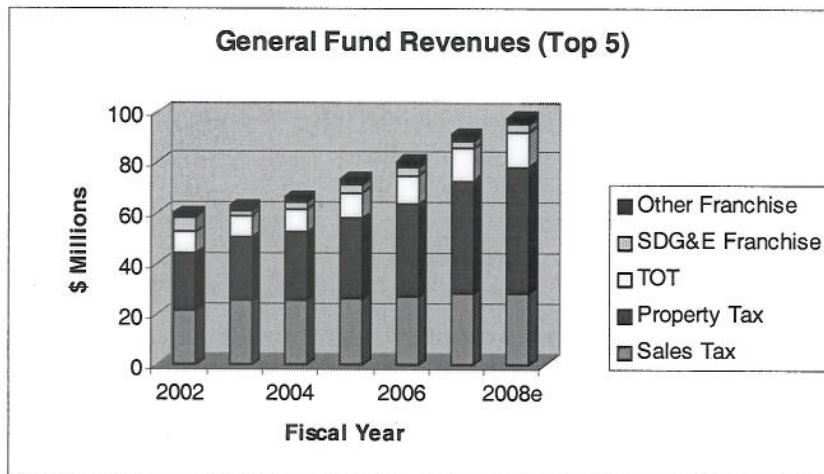
For the future, there are several new tourist-serving projects in development. The La Costa Resort has been developing up to 197 commercial resort villas on their site and part of the increases in TOT to date can be attributed to several of these villas coming on line. As they are phased in over the next several years, it is expected to add over \$1.4 million in TOT when completed. Two hotels near the airport are expected to open during Fiscal Year 2007-08. The two hotels are the Hampton Inn and Homewood Suites, located near the McClellan/Palomar Airport. They are expected to add 249 hotel rooms, bringing the total available hotel rooms in the City to about 3,700. These two new hotels are estimated to generate \$500,000 per year in TOT. In addition, a new project next to Legoland is currently under construction and is expected to bring on 350 hotel rooms and 350 timeshare units. This project is expected to be phased in over time, and is expected to generate an additional \$1.4 - \$1.7 million per year in TOT.

It is the Council's goal to ensure that the City remains in good financial health, and there are a number of steps the City has taken to attain that goal. One of these is the Growth Management Plan. This plan was adopted by the citizens to ensure that all necessary public facilities were constructed along with development. It also ensures that a financing plan is in place to pay for the facilities prior to the development of the property.

In addition to the Growth Management Plan, the City also prepares a long-term financial model for both the capital and operating needs of the City. With a growing city such as Carlsbad, it is imperative that we plan for the impacts of serving new development and operating new public facilities, as well as planning for the capital needed to build them. Thus, the City prepares a ten-year operating forecast for the General Fund, and a 20+ year Capital Improvement Program. As part of the Capital Improvement Program, the City annually calculates the amounts needed to pay for the various projects, and calculates the anticipated operating budget impacts. In this way, we can anticipate the effects of development from both a capital and an operating perspective.

One important initiative the City has undertaken to ensure its financial health, is the development of an Infrastructure Replacement Fund. With this fund, the City sets aside money on an annual basis for major maintenance and replacement of its infrastructure. Much of the City's infrastructure is relatively new; thus, the City has not felt the full impact of maintenance. By setting aside funds now, the citizens of Carlsbad can be assured that the proper maintenance and replacement, when needed, will be performed on streets, parks, and many facilities for which the City is responsible.





Carlsbad's current economic position is an enviable one. A relatively healthy local economy over the past ten years provided additional revenue-generating sites that allow the City to continue to add new facilities and services for the citizens. The City hosts three regional shopping areas within its boundaries: a large regional mall, an outlet center and a high-end retail center in the

southern part of town called The Forum. Together, these sites contribute approximately \$4.5 million annually to the City's sales taxes. The City's Auto Mall generates another \$6.0 million per year in sales taxes for the City. Legoland, a family theme park, contributes to the City's sales tax base and stimulates the development of new hotels in the area. The effect of the new development and the demand for housing in Carlsbad is an increasing tax base. The four major revenue sources for the City: property taxes, sales taxes, transient occupancy taxes (TOT) and franchise taxes, are expected to provide \$91 million, or 80%, of the City's General Fund revenues in FY 2006-07. These taxes and fees are the major source of funding for most of the City's services, and allow the City to live up to its reputation as one of the premier locations in San Diego County.

The City's base sales taxes are projected to grow by 1.8% for Fiscal Year 2007-08 due to the slowdown in the economy. While the growth in housing prices is expected to moderate due to the cooling of the real estate market, there is a lag with the property tax revenue and therefore, according to the County Assessor, the City should expect property tax revenues to increase by over 11% for FY 2007-08. New building permits are expected to continue to slow and the development related revenue items have been reduced accordingly for Fiscal Year 2007-08. And finally, tourism is expected to continue to be strong, with TOT receipts projected to grow by 6% in the future, with the addition of more available rooms. More information on all of the City's revenues and programs can be found in the later sections of this document.



**State of California** - In addition to the soft housing market and a slow economy, the state of California's fiscal problems also cast a shadow on the City's economic future. The state of California has been in a severe fiscal crisis for a number of years. Through a variety of loans, one-time revenues, interfund borrowings and raids on city, county and special district funds, it has been able to manage its cash flows and stay solvent. However, more drastic measures will be needed for the State to finally get its budget in balance.

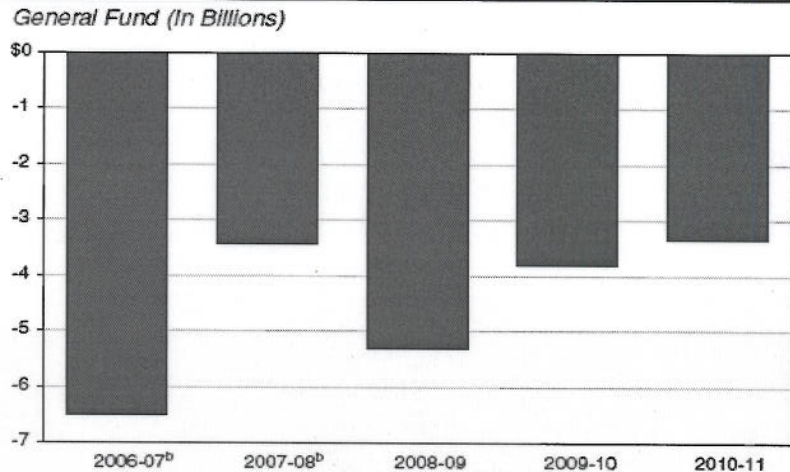
According to the Legislative Analyst's Office (LAO), the State is facing significant deficits in future years despite the stronger revenues seen in the past few years. The LAO's analysis of the Governor's budget proposal for 2007-08 reflects that the State is proposing to use a significant portion of their fund balance to cover their operating shortfall, and \$3 to 5 billion shortfalls are expected to exist in each of the next several years. According to the LAO, the ongoing budget shortfalls result from the high reliance in the near term on one-time savings. The State has balanced its budget by taking City money in the past, and the risk is that they may find a way to make it happen again.



## State of California

As a result of the continued attacks on cities' revenues, a coalition of cities, counties and special districts supported Proposition 1A which was approved by the voters in November 2004. The measure included a provision to help prevent the Legislature from reducing the combined property tax shares of cities, special districts, and the county, except to borrow the funds on a temporary basis to address a "severe state fiscal hardship".

### Significant Operating Shortfalls<sup>a</sup> Would Persist



<sup>a</sup> Annual revenues minus expenditures. Legislative Analyst's Office estimates of Governor's revenue and expenditure policies.

<sup>b</sup> Includes expenditures of \$283 million in 2006-07 for Proposition 98 settle-up and \$300 million in 2007-08 for Quality Education Investment Act that the administration shows as prior-year spending.

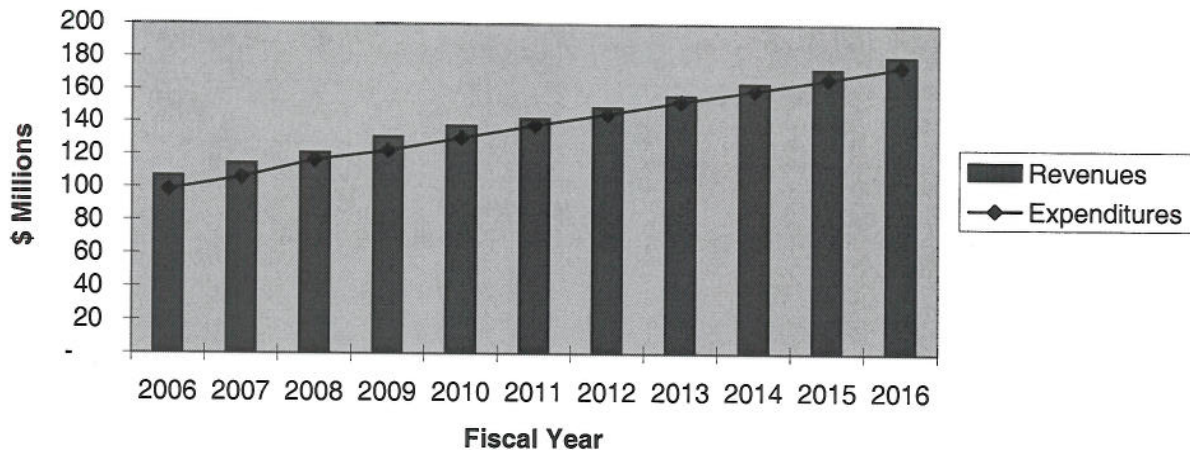
### Looking Forward

As stated earlier in this document, the City prepares ten-year forecasts for the General Fund each year in order to understand the effects of actions taken today on the City's future. The City has experienced remarkable revenue growth over the past ten years due to the development of the majority of its commercial sites. The future will bring a few more commercial sites but at a slower pace, while residential development will continue for a number of years. There are also quite a few City facilities – mainly parks and civic facilities – planned in the future to serve the growing population. The new facilities will add operating costs to the City's General Fund budget as they are completed and opened for use.

These factors alone will cause the General Fund costs to escalate at a higher rate than inflation. In addition, a number of other factors – mainly rising retirement and health care costs – have created upward pressure on expenditures, especially over the past several years. These factors have been incorporated into the General Fund forecast shown below and projected over the next ten years. While no forecast is ever totally accurate, it does represent a likely scenario given the assumptions on which it is built.

This forecast assumes that revenue growth will continue at a moderate pace in 2007-08 and into the future. To project the expenditures, it includes all known personnel costs, most of which have been negotiated with the employee groups through December 2007. The City will be negotiating labor contracts with all four groups during FY 2007-08.

## General Fund Revenues and Expenditures

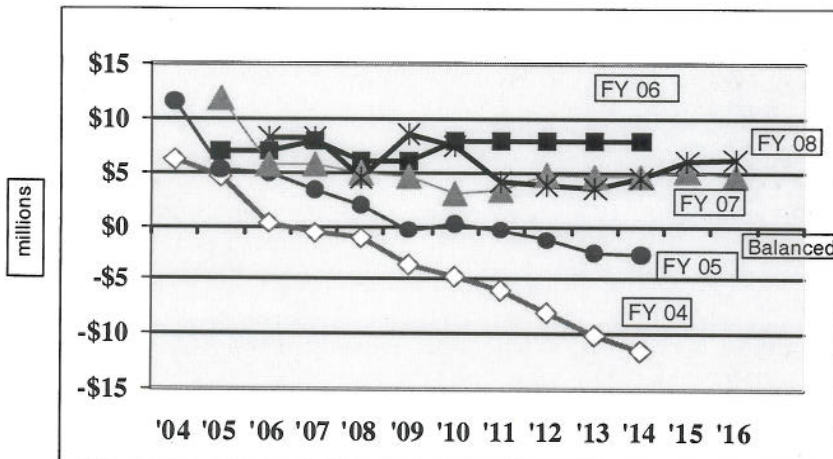


The forecast assumes 10% annual increases in health care costs in the near future, slowing to 5% annually in the distant future. It also assumes personnel growth (new positions) to remain rather flat at no more than 2% per year. Cost of living increases between 3% and 5% have been added to personnel costs. Pension plan costs are anticipated to remain essentially at current levels. It assumes that the contribution from the General Fund to the Infrastructure Replacement Fund is 6.5% of General Fund revenues. And finally, it includes estimated operating costs for all capital projects in the timeframes shown in the Capital Improvement Program (CIP). One of the biggest assumptions in the forecast is that services remain the same. No new services have been anticipated, although growth in current services to match the growing population has been incorporated.

The results show that the General Fund is balanced into the future, with a slight surplus in each year of 2% to 7% depending on which year. This achieves the goal set out by Council to maintain a balanced budget.

The situation was different several years ago when the forecast projected that the City was headed for deficits unless corrective measures were taken. For the past several years, Council and staff have worked to bring the forecast back into balance. Through a combination of enhancing revenue sources and finding more efficient methods of providing services (and with the help of a strong local economy), the City was able to turn the forecast around from heading into deficits to a healthy balance.

### City of Carlsbad 10-Year Financial Forecast



One of the more significant revenue enhancements that occurred in November 2004 was the passage of the reauthorization of Transnet revenues. Transnet is a ¼ cent additional sales tax collected countywide and used to improve the transportation systems. The current authorization for the sales tax was to end in 2008. SANDAG, the San Diego Association of Governments, placed a



measure on the November 2004 ballot to reauthorize the sales tax for another 40 years. The measure passed, providing the City \$1.5 million in annual taxes to be spent on street repair, maintenance and construction.

The ability to understand the future impacts of both changes in revenue sources as well as program needs, is crucial to ensure that the City has the funds available to make its future plans come true. The General Fund forecast is a tool available to the City to achieve the goal of managing its fiscal resources effectively and monitoring the achievement of sustainable economic health for the City of Carlsbad.